

# Michigan Law Review

---

Volume 88 | Issue 7

---

1990

## Adequate Protection and Administrative Expense: Toward a Uniform System for Awarding Superpriorities

Julia A. Goatley

*University of Michigan Law School*

Follow this and additional works at: <https://repository.law.umich.edu/mlr>



Part of the [Bankruptcy Law Commons](#)

---

### Recommended Citation

Julia A. Goatley, *Adequate Protection and Administrative Expense: Toward a Uniform System for Awarding Superpriorities*, 88 MICH. L. REV. 2168 (1990).

Available at: <https://repository.law.umich.edu/mlr/vol88/iss7/6>

This Note is brought to you for free and open access by the Michigan Law Review at University of Michigan Law School Scholarship Repository. It has been accepted for inclusion in Michigan Law Review by an authorized editor of University of Michigan Law School Scholarship Repository. For more information, please contact [mlaw.repository@umich.edu](mailto:mlaw.repository@umich.edu).

## NOTES

### Adequate Protection and Administrative Expense: Toward a Uniform System for Awarding Superpriorities

One purpose of the Bankruptcy Code (Code),<sup>1</sup> as amended in 1978, was to encourage the reorganization of bankrupt companies and individuals.<sup>2</sup> The provisions of the Code addressing reorganization are becoming increasingly important as the number of bankruptcies, and the volume of involved assets, soar.<sup>3</sup> Recent bankruptcies result from a variety of causes such as large debt portfolios produced by "merger madness,"<sup>4</sup> potential mass tort liability,<sup>5</sup> and avoidance of collective bargaining agreements.<sup>6</sup> The reorganizations of these companies, and of smaller businesses and personal estates, often depend on the use of prepetition assets.

The Code attempts to protect secured creditors while enabling the debtor to use collateral during reorganization. By granting the debtor an automatic stay<sup>7</sup> of the collection of creditors' claims and concurrently guaranteeing creditors "adequate protection" of their collateral,

---

1. 11 U.S.C. §§ 101-1330 (1988).

2. Congress recognized that the provisions of the Bankruptcy Act had produced negative results and few consummated plans. See 135 CONG. REC. S3549 (daily ed. Apr. 10, 1989) (statement of Sen. DeConcini) ("The purpose of the Bankruptcy Code is to encourage the reorganization, and not the liquidation, of financially troubled organization."); 124 CONG. REC. 33990 (1978) (statement of Sen. DeConcini) (Broader chapter 13 coverage would allow "for greater payouts to creditors . . ."); 123 CONG. REC. 35445, 35446 (1977) (statement of Rep. Edwards) (Bankruptcy Act's reorganization chapters offered insufficient power and resulted in "creditors [getting] very little."). Representative Edwards noted that under Chapter 11 of the Code, [f]or both debtors and creditors, the requirements for a reorganization plan are made more flexible, and the court is given the power to confirm the plan even though some creditors do not like the plan, so long as the plan meets certain statutory criteria of fairness. This is very important. This way creditors get more than if the business went into straight liquidation.

It also will save more businesses, which will protect jobs and protect public and private investors.

123 CONG. REC. 35445, 35446 (1977).

3. Greenwald, *The Profits of Doom*, TIME, Mar. 19, 1990, at 41; MacLachlan, *A Demand Spiral for Bankruptcy Specialists*, CHI. TRIB., Feb. 25, 1990, § 7, at 5; Hornik, *Better Watch Out*, TIME, Feb. 12, 1990, at 48; Donovan, *Merger Mania Slump Is a Bankruptcy Boom*, INVESTOR'S DAILY, Jan. 26, 1990, at 1.

4. See Clark & Malabre, *Borrowing Binge: Takeover Trend Helps Push Corporate Debt and Defaults Upward* WALL ST. J., Mar. 15, 1988, at 1, col. 6, reprinted in 134 CONG. REC. S3439 (daily ed. Mar. 30, 1988); Greenwald, *supra* note 3.

5. See Address by Hon. Hamilton Fish, Jr., AM. BANKR. INST. 2d ANN. MID-WINTER LEADERSHIP CONF. (Feb. 17, 1988), reprinted in 134 CONG. REC. 2488 (1988) (remarks by Hon. Moorhead).

6. See 135 CONG. REC. S3549 (daily ed. Apr. 10, 1989) (statement of Sen. DeConcini).

7. The automatic stay is provided by 11 U.S.C. § 362(a) (1988) and is designed to "stop[] all collection efforts, all harassment, and all foreclosure actions." H.R. REP. NO. 595, 95th Cong., 2d Sess. 340, reprinted in 1978 U.S. CODE CONG. & ADMIN. NEWS 5963, 6297 [hereinafter

the Code balances competing interests in bankruptcy. The approach taken by section 361 of the Code, which identifies three modes of adequate protection, is based both on policy grounds, ensuring creditors "the benefit of their bargain," and constitutional grounds, ensuring the fifth amendment guarantee of protection of property.<sup>8</sup>

Congress intended the Code to define both the extent of creditor protection and the permissible methods of granting such protection.<sup>9</sup> Although the Code provides for sufficient means of adequate protection, neither the Code nor the Bankruptcy Rules<sup>10</sup> effectively addresses the procedural steps for obtaining adequate protection. The Code also fails to identify the relationship between administrative expenses and adequate protection. These omissions have resulted in disagreement among courts concerning a number of issues and an ensuing divergence as to when courts grant adequate protection. Some courts question whether adequate protection must be requested and authorized by the court in order to qualify for "administrative expense superpriority."<sup>11</sup> This Note analyzes the policy considerations supporting a requirement of creditor action prior to an adequate protection grant. Based on this analysis, this Note suggests revisions to the Code and Bankruptcy Rules that would result in an equitable balancing of the responsibilities placed on debtors and creditors.

Part I of this Note reviews the legislative history of relevant Code sections and the Code language that pertain to the granting of adequate protection. Section 361 of the Code provides for three types of adequate protection. Sections 362, 363, and 364 set out instances when actions by the trustee that result in a decrease in the value of a secured party's interest require the provision of adequate protection. Finally, sections 503 and 507 designate circumstances when prepeti-

---

HOUSE REPORT]. See *infra* note 17 for relevant text in Code section providing for automatic stay.

8. Congress noted that the concept of adequate protection

is derived from the fifth amendment protection of property interests. . . . The section, and the concept of adequate protection, is [sic] based as much on policy grounds as on constitutional grounds. Secured creditors should not be deprived of the benefit of their bargain. . . . [T]he purpose of [alternate means of protection] is to insure that the secured creditor receives in value essentially what he bargained for.

HOUSE REPORT, *supra* note 7, at 339, *reprinted* at 6295.

For a discussion of the relationship between the fifth amendment protection against taking of property and the concept of adequate protection, see Rogers, *The Impairment of Secured Creditors' Rights in Reorganization: A Study of the Relationship Between the Fifth Amendment and the Bankruptcy Clause*, 96 HARV. L. REV. 973 (1983); Comment, *Adequate Protection and the Automatic Stay Under the Bankruptcy Code: Easing Restraints on Debtor Reorganization*, 131 U. PA. L. REV. 423 (1982); Comment, *The Recovery of Opportunity Costs as Just Compensation: A Takings Analysis of Adequate Protection*, 81 NW. U. L. REV. 953 (1987).

9. HOUSE REPORT, *supra* note 7, at 5, *reprinted* at 5966 ("[The bill] defines the protections to which a secured creditor is entitled, and the means through which the court may grant that protection.").

10. 11 U.S.C. app. — Bankruptcy Rules 1001-X1010.

11. See *infra* notes 33-34 and accompanying text.

tion secured creditors are eligible to receive administrative expenses. Section 507(b) authorizes allowance of an administrative expense claim when the adequate protection provided to a secured creditor fails.

Part II of this Note analyzes the conditions a creditor must satisfy to receive adequate protection. This Part argues that a creditor's request to the court for adequate protection should be enough to invoke the right to administrative expense priority and suggests a Code revision to promote such an outcome. Part III addresses the issue, currently left unresolved by the Code and the Bankruptcy Rules, of whether adequate protection must be requested from and approved by the court. This Note concludes by proposing an effective system of notice and routine court approval that would address the major policy concerns of private agreements and could be provided with only minor revisions of the Bankruptcy Rules.

## I. BACKGROUND AND STATUTORY LANGUAGE

Congress enacted section 361 of the Code to ensure that the secured creditor receives the value for which she bargained.<sup>12</sup> This Part reviews the methods of providing adequate protection and the circumstances in which such protection is available to a creditor. Section I.A discusses the three methods the Code specifies as forms of adequate protection. Section I.B explores the granting of an administrative expense allowance and its relationship with adequate protection.

### A. Adequate Protection

Section 361 provides three alternative methods which protect the secured creditor by preserving the value of collateral during the debtor's reorganization.<sup>13</sup> These methods are (1) cash payments; (2)

---

12. See *supra* note 8 and accompanying text.

13. Section 361 provides in full:

When adequate protection is required under section 362, 363, or 364 of this title of an interest of an entity in property, such adequate protection may be provided by —

(1) requiring the trustee to make a cash payment or periodic cash payments to such entity, to the extent that the stay under section 362 of this title, use, sale, or lease under section 363 of this title, or any grant of a lien under section 364 of this title results in a decrease in the value of such entity's interest in such property;

(2) providing to such entity an additional or replacement lien to the extent that such stay, use, sale, lease, or grant results in a decrease in the value of such entity's interest in such property; or

(3) granting such other relief, other than entitling such entity to compensation allowable under section 503(b)(1) of this title as an administrative expense, as will result in the realization by such entity of the indubitable equivalent of such entity's interest in such property.

11 U.S.C. § 361 (1988).

This section does not apply in Chapter 12 bankruptcies (bankruptcies of family farmers). However, § 1205 establishes four similar methods of adequate protection for those bankruptcies: cash payments, additional liens, reasonable rent, and other relief that protects the value of the property. 11 U.S.C. § 1205 (1988).

additional or replacement liens; and (3) other relief resulting in the "indubitable equivalent" of the secured party's interest. Congress did not intend these methods to be "exhaustive or exclusive."<sup>14</sup> The only method of adequate protection disallowed is the "entitle[ment] . . . to compensation allowable under section 503(b)(1) . . . as an administrative expense . . . ."<sup>15</sup> Section 507(b), however, does allow administrative expenses to be granted when adequate protection fails.<sup>16</sup>

Whereas the adequate protection methods suggested in section 361 are designed to protect creditors, section 362 allows for an automatic stay intended to protect both the creditors and the debtor of a bankrupt estate.<sup>17</sup> In Chapter 11 cases, the automatic stay of proceedings and actions against the debtor is imposed when a debtor files a petition. Congress noted, when considering the 1978 Code amendments, that "a race of diligence by creditors for the debtor's assets prevents [an orderly liquidation procedure]."<sup>18</sup> The automatic stay provides a debtor with time to reorganize his assets without having to respond to financial pressures from individual creditors. Creditors benefit from the stay because preferential treatment of "fast acting" creditors is avoided and all creditors are treated equally.

Since the automatic stay disturbs the rights of creditors by disallowing foreclosure, the continuation of the stay is predicated on certain conditions. Of particular interest to creditors is the Code's requirement that adequate protection be given to a creditor whose collateral is depreciating or being consumed. Specifically, section

---

14. HOUSE REPORT, *supra* note 7, at 339, *reprinted* at 6295 (Adequate protection "matters are left to case-by-case interpretation. . . . There are an infinite number of variations possible in dealings between debtors and creditors, the law is continually developing, and new ideas are continually being implemented in this field. The flexibility is important to permit the courts to adapt to varying circumstances and changing modes of financing.").

15. 11 U.S.C. § 361(3) (1988). See *supra* note 13 for relevant text.

16. See *infra* note 31 for text of § 507(b). Courts disagree on whether administrative expenses can be allowed when adequate protection was never requested. Compare *In re Center Wholesale, Inc.*, 759 F.2d 1440, 1451 n.23 (9th Cir. 1985) (granting § 507(b) compensation, despite debtor's failure to provide adequate protection in the first place, as within the "spirit" of the Code) and *In re Prime*, 37 Bankr. 897 (Bankr. W.D. Mo. 1984) (denying adequate protection in the absence of demand by creditor, but giving administrative expense allowance for depreciation of collateral due to use) with *In re Advisory Info. & Mgmt. Sys.*, 50 Bankr. 627 (Bankr. M.D. Tenn. 1985) (§ 503 was not intended to provide administrative expenses for use of collateral) and *In re Briggs Transp. Co.*, 47 Bankr. 6 (Bankr. D. Minn. 1984) (burden on creditors to seek relief and demand adequate protection). See *infra* notes 54-78 and accompanying text.

17. Section 362 provides that a petition filed under §§ 301, 302, or 303 of the Code operates as a stay of various acts including:

- (3) any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate;
- (4) any act to create, perfect, or enforce any lien against property of the estate;
- (5) any act to create, perfect, or enforce against property of the debtor any lien to the extent that such lien secures a claim that arose before the commencement of the case under this title . . . .

18. 11 U.S.C. § 362(a)(3)-(a)(5) (1988).

19. S. REP. NO. 989, 95th Cong., 2d Sess. 49, *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS 5787, 5835 [hereinafter SENATE REPORT].

362(d)(1) states that relief from the automatic stay must be granted "[o]n request of a party in interest" when adequate protection is lacking.<sup>19</sup>

Section 363 of the Code also requires adequate protection in some circumstances. This section regulates the trustee's ability to sell, use, or lease the property of the estate other than in the ordinary course of business. Under this section, the court can prohibit the nonordinary course sale, use, or lease of noncash collateral, or the court can condition any similar disposition on the provision of adequate protection. Such action by the court must occur "at any time, on request of an entity that has an interest in [the] property."<sup>20</sup> Cash collateral is given greater protection in that the sale, use, or lease of the collateral is prohibited unless the secured party consents or the court expressly authorizes the action.<sup>21</sup> Bankruptcy Rule 4001 requires notice and a possible hearing prior to the use of any collateral covered by section 363.<sup>22</sup>

Bankruptcy Rule 6004 addresses the procedural requirements governing the notice of proposed use, sale, or lease of collateral and the filing of objections to such actions.<sup>23</sup> A recently proposed amendment to Bankruptcy Rule 4001 sets out similar requirements for motions filed to prohibit or condition the use, sale, or lease of property under section 363(e).<sup>24</sup> Part III of this Note will analyze the adequacy of this notice and the effectiveness of the proposed rule. Based on this analysis, it is suggested that similar notice and hearing procedures should be required for all adequate protection agreements.

Section 364 governs efforts by the debtor to obtain credit, the third situation in which the Code requires adequate protection. A trustee or debtor in possession often needs to obtain additional credit in order to

---

19. Section 362(d) provides in part:

On request of a party in interest and after notice and a hearing, the court shall grant relief from the stay provided under subsection (a) of this section, such as by terminating, annulling, modifying, or conditioning such stay —

(1) for cause, including the lack of adequate protection of an interest in property of such party in interest . . . .

11 U.S.C. § 362(d) (1988).

The Code does not specify what actions constitute a request. There has been disagreement among courts over the definition of the term. See *infra* notes 122-32 and accompanying text.

20. Section 363(e) provides in full:

Notwithstanding any other provision of this section, at any time, on request of an entity that has an interest in property used, sold, or leased, or proposed to be used, sold, or leased, by the trustee, the court, with or without a hearing, shall prohibit or condition such use, sale, or lease as is necessary to provide adequate protection of such interest.

11 U.S.C. § 363(e) (1988).

21. 11 U.S.C. § 363(c)(2) (1988).

22. 11 U.S.C. app. — Bankruptcy Rule 4001(b).

23. 11 U.S.C. app. — Bankruptcy Rule 6004.

24. Comm. on Rules of Practice and Procedure, Judicial Conf. of the U.S., Preliminary Draft of Proposed Amendments to the Bankruptcy Rules, Aug. 1989, at 105, [hereinafter Proposed Rules] reprinted in 880 F.2d CLXXIV, CCCIII (West's Advanced Rptr., Sept. 18, 1989).

reorganize the business and estate. If unsecured credit is not available, the court can authorize senior or equal liens on property subject to prepetition liens. Section 364 authorizes senior or equal liens only after adequate protection has been secured for the other lienholders of the collateral property.<sup>25</sup> Nothing in section 364 suggests that creditors have a duty to request adequate protection in these instances. Rather the section implies that adequate protection must be provided before senior or equal liens on the property may be granted.<sup>26</sup> Bankruptcy Rule 4001 sets out time limits, filing requirements, and necessary notice service for motions to obtain credit.<sup>27</sup>

In sum, section 361 suggests three ways in which adequate protection may be provided when reorganization of the bankrupt estate seriously impairs a secured creditor's collateral. Sections 362, 363, and 364 indicate certain instances where adequate protection is explicitly required due to an impairment of the collateral. Though the methods of adequate protection provided in section 361 are not exclusive, Congress explicitly excluded the granting of adequate protection through administrative expense priority. The one exception to this exclusion is provided by section 507, which allows administrative expense priority when the original adequate protection provided to a secured creditor fails.

### B. *Administrative Expenses*

Section 507 sets out the priority of claims against a bankrupt estate. Administrative expenses are given the highest priority. These expenses, defined in section 503(b), include "the actual, necessary costs and expenses of preserving the estate."<sup>28</sup> Originally, the drafters

---

25. Section 364(d)(1) provides in full:

The court, after notice and a hearing, may authorize the obtaining of credit or the incurring of debt secured by a senior or equal lien on property of the estate that is subject to a lien only if —

(A) the trustee is unable to obtain such credit otherwise; and

(B) there is adequate protection of the interest of the holder of the lien on the property of the estate on which such senior or equal lien is proposed to be granted.

11 U.S.C. § 364(d)(1) (1988).

26. The wording of § 364 — "only if . . . there is adequate protection" — suggests that adequate protection under its provision is automatic. By contrast, §§ 362 and 363 both contain wording which indicates that adequate protection will be provided only on the request of the creditor. Neither the automatic stay nor the use, sale, or lease of noncash collateral under these sections is conditioned on the provision of adequate protection. See *supra* notes 17, 19, 20, and 25 for relevant text of statutes.

27. 11 U.S.C. app. — Bankruptcy Rule 4001(c).

28. 11 U.S.C. § 503(b)(1)(A) (1988). Collier states that under § 503(b)

[p]ermissible expenses may include the actual, necessary costs and expenses of preserving the estate, such as wages, salaries or commissions for services rendered after the order for relief; any taxes on, measured by, or withheld from such wages, salaries or commissions . . . . To some extent, . . . what constitute actual and necessary costs and expenses of preserving an estate is open to judicial construction.

2 COLLIER'S BANKRUPTCY MANUAL ¶ 503.03 (3d ed. 1989).

of the Code included administrative expense priority as a method of adequate protection. Provision for this method of adequate protection was eventually deleted from section 361 because the drafters became concerned that too often the assets would be inadequate to meet all the administrative expense claims.<sup>29</sup> To ensure that administrative expenses would not be used as a method of adequate protection by debtors, section 361(c) specifically excludes section 503(b)(1) compensation as a form of adequate protection.

In the final version of section 361, Congress still wished to ensure protection for those creditors who received adequate protection that later proved to be insufficient.<sup>30</sup> To that end, Congress added section 507(b) which provides that when adequate protection of a prepetition secured party's interest fails, the first priority afforded to postpetition administrative expenses can be superseded. Section 507(b) states that when a creditor still has an administrative expense claim despite the provision of adequate protection, that "creditor's claim . . . shall have priority over every other claim allowable."<sup>31</sup> This type of claim arises, for example, when payments agreed upon as adequate protection are not made, or when adequate protection does not turn out to be the "indubitable equivalent." The priority granted by section 507(b) is commonly called a superpriority.<sup>32</sup>

The allowability of administrative expenses for prepetition secured creditors is a confused issue and the relationship between adequate protection and administrative expenses remains unclear. As one court has noted, the confusion is due to the tension "between the expenses allowed in § 507(b), as defined in § 507(a)(1), and the prohibitions found in § 361(3)."<sup>33</sup> The first step in understanding this tension is determining when adequate protection may be granted, either through the methods in section 361 or through an allowance of administrative expenses.

---

29. 124 CONG. REC. 32350, 32395 (1978) (statement of Hon. Don Edwards, Chair. of the SubComm. on Civil and Constitutional Rights of the House Comm. on the Judiciary upon introducing the House Amendment to the Senate Amendment to H.R. 8200) [hereinafter *Edwards Statement*].

30. *Id.* at 32395.

31. Section 507(b) provides in full:

If the trustee, under section 362, 363, or 364 of this title, provides adequate protection of the interest of a holder of a claim secured by a lien on property of the debtor and if, notwithstanding such protection, such creditor has a claim allowable under subsection (a)(1) of this section arising from the stay of action against such property under section 362 of this title, from the use, sale, or lease of such property under section 363 of this title, or from the granting of a lien under section 364(d) of this title, then such creditor's claim under such subsection shall have priority over every other claim allowable under such subsection.

11 U.S.C. § 507(b) (1988).

32. See 2 COLLIER'S BANKRUPTCY MANUAL ¶ 507.08 (3d ed. 1989).

33. *In re Smith*, 75 Bankr. 365, 369 (W.D. Va. 1987).



## II. ADEQUATE PROTECTION AND ADMINISTRATIVE EXPENSES

A creditor may be awarded adequate protection through the section 361 methods and, if adequate protection proves inadequate to satisfy the creditor's claim, a creditor may gain additional protection through allowance of administrative expenses as provided in section 507(b). Section II.A discusses the requirements a creditor must meet to receive adequate protection pursuant to sections 362, 363, and 364. In most cases, the creditor must take affirmative steps to receive adequate protection; section 364 presents the only exception to this rule. Section II.B discusses whether the creditor is entitled to section 507(a) expenses directly and explores the relationship between the restriction of administrative expenses as a form of adequate protection and the grant of such expenses under 507(b).

### A. Obtaining Adequate Protection Under Sections 362, 363, and 364

As discussed in Part I, adequate protection, as described in section 361, must be granted when required under sections 362, 363, and 364. Unquestionably, adequate protection is available through these sections and is in some cases obligatory. In a few situations, however, the application of the Code with respect to a creditor's claim has unfairly penalized the creditor.<sup>34</sup> To understand these problems properly, it is necessary first to understand the requirements sections 362-364 place on creditors and the justifications for those requirements. The process a creditor must follow varies slightly with each of the Code sections requiring adequate protection.

Adequate protection may be granted by the court under section 362 if relief from the automatic stay is denied. The wording of section 362 makes it clear that the debtor is under no duty to provide adequate protection except "[o]n request of a party in interest."<sup>35</sup> As noted by Collier, this language places the burden of initiating a motion for relief from stay on the "party affected."<sup>36</sup> Once the creditor makes such a request, the debtor must propose a mode of protection that protects the creditor from any decline in the value of her collateral.<sup>37</sup>

---

34. See *In re James B. Downing & Co.*, 94 Bankr. 515 (Bankr. N.D. Ill. 1988) (administrative expense priority denied when early adequate protection request found moot); see also *In re Smith*, 75 Bankr. 365 (W.D. Va. 1987) (denial of administrative expense priority despite early adequate protection request); *infra* notes 82-83 and accompanying text.

35. 11 U.S.C. § 362(d) (1988); see *supra* note 19 for relevant text.

36. 1 COLLIER'S BANKRUPTCY MANUAL ¶ 362.06, at 362-45 (3d ed. 1989). The request for relief should include an alternative motion for adequate protection in case the court denies such relief.

37. Section 362(g) states:

In any hearing under subsection (d) or (e) of this section concerning relief from the stay of any act under subsection (a) of this section —

(1) the party requesting such relief has the burden of proof on the issue of the debtor's equity in property; and

The court hears arguments only if the parties cannot agree on what constitutes adequate protection.

Section 362's requirement that a secured creditor request adequate protection is justified on policy grounds. The stay is automatic upon the filing of either a voluntary or involuntary petition for relief under the Code.<sup>38</sup> Each creditor receives notice of the creditors' meeting and thus has sufficient warning that her collateral may be affected and that a request for relief from stay may be desirable.<sup>39</sup> The language of section 362 suggests that the debtor may continue using the collateral until a request for adequate protection is made.<sup>40</sup> Forcing the debtor to provide adequate protection to all creditors automatically might hinder the debtor's reorganization ability since he constantly would have to review all creditors' collateral positions. An automatic presumption of adequate protection would conflict with the Code's policy of supporting reorganization and favoring postpetition lenders. Instead, by holding the prepetition creditor to some level of diligence and responsibility in protecting her collateral, the debtor can work towards a successful reorganization by using the collateral until adequate protection is requested.<sup>41</sup> The provision of adequate protection and the valuation of assets is often disputed by the creditor and thus requires negotiation and, sometimes, court determination. The request requirement avoids delays associated with negotiations until a creditor actually asks for adequate protection. In view of the benefits, requiring the creditor to request adequate protection does not seem unduly burdensome.

The procedure for obtaining adequate protection under section 363 is similar to that just outlined for section 362. Again the wording of the statute clearly requires a "request [from] an entity that has an interest in property used, sold, or leased" to trigger the required protection.<sup>42</sup> Upon a request by the creditor, the bankruptcy court will condition the sale, use, or lease of the collateral on the provision of adequate protection. The creditor receives notice under Bankruptcy Rule 6004 of a proposed disposition of property.<sup>43</sup> This rule ensures that the creditor is informed of any events under section 363 that might affect the value of the collateral. As under section 362, it is appropriate to require the creditor to request adequate protection in order to receive it.<sup>44</sup> If the creditor does not respond to the notice of

---

(2) the party opposing such relief has the burden of proof on all other issues.

11 U.S.C. § 362(g) (1988).

38. 11 U.S.C. § 362(a) (1988).

39. 11 U.S.C. § 342 (1988); 11 U.S.C. app. — Bankruptcy Rule 2002.

40. 11 U.S.C. § 362 (1988); see *supra* note 19 for relevant text.

41. See *infra* notes 120-30 and accompanying text.

42. 11 U.S.C. § 363(e) (1988); see *supra* note 20 for relevant text.

43. 11 U.S.C. app. — Bankruptcy Rule 6004.

44. See *infra* Part III.

sale, use, or lease of property, the debtor should be able to make the planned disposition without first determining the creditor's position with respect to collateral. To require more on the part of the debtor could seriously delay reorganization activities while every secured creditor's collateral position was being determined. Notice leaves the monitoring activities to the creditor whose collateral is affected.

As opposed to the provisions in sections 362 and 363, section 364 does not appear to require affirmative creditor action to ensure adequate protection when senior or equal liens are granted on collateral.<sup>45</sup> The legislative history of section 364 indicate that the debtor has an affirmative duty to provide adequate protection before senior or equal liens may be attached to the collateral.<sup>46</sup> This automatic provision of adequate protection would be necessary if a creditor were unaware that additional liens were being placed on her collateral and that adequate protection might be necessary. In 1987, however, Bankruptcy Rule 4001 was amended to require notice of all additional liens. After the amendment, any motion for additional credit made under section 364 should include a description of the collateral.<sup>47</sup> This requirement should provide sufficient notice to all creditors, making an automatic grant of adequate protection less warranted.

An issue related to the type of request necessary for adequate protection is the question of when such a request should be made. Neither section 362 nor section 363 indicates the proper timing of an adequate protection request. Furthermore, nothing in any of the adequate protection sections suggests that a creditor waives adequate protection by failing to make a request within a certain time period. However, in order to prevent last minute requests for adequate protection covering postpetition loss in collateral, several courts have held that the adequate protection provided for a creditor should be measured from the date the creditor formally requests such protection from the court.<sup>48</sup>

A few courts disagree with this position and set other events as the benchmark of damages.<sup>49</sup> The date-of-request method provides full protection to a diligent creditor and minimizes the chance that credi-

---

45. See *supra* notes 25-26 and accompanying text.

46. The House Committee on the Judiciary noted when drafting § 364:

The court may authorize such a superpriority only if the trustee is otherwise unable to obtain credit, and if there is adequate protection of the original lien holder's interest. HOUSE REPORT, *supra* note 7, at 347, reprinted at 6303.

47. Notes of Advisory Committee on Rules — 1987 Amendment, Bankruptcy Rule 4001, reprinted in 11 U.S.C. app. at 257-58.

48. E.g., *In re Ritz-Carlton of D.C., Inc.*, 98 Bankr. 170, 173 (S.D.N.Y. 1989); *In re Wilson*, 70 Bankr. 46, 48 (Bankr. N.D. Ind. 1987); *In re Haiflich*, 63 Bankr. 314, 317 (Bankr. N.D. Ind. 1986). See *infra* notes 122-32 and accompanying text for a detailed discussion of these cases.

49. Not all courts require a formal request for adequate protection. The court in *Hinckley* measured depreciation from the date the creditor informed the debtor that he would be seeking adequate protection. *In re Hinckley*, 40 Bankr. 679, 681-82 (Bankr. D. Utah 1984).

tors, waiting until the eve of confirmation to request adequate protection, will successfully veto any plan.<sup>50</sup> Even if creditors make late requests, measuring the loss to collateral from the date of formal request lowers the chance that the award would be fatal to a confirmation plan. A third position, that failure to request adequate protection results in a waiver of administrative expense claims, is discussed in section II.B below.

Although the language of sections 362, 363, and 364 is clear regarding a creditor's duty to ask for adequate protection, confusion has arisen concerning several related issues. First, the relationship between the section 361 restrictions on providing adequate protection through granting administrative expense status and the language of section 507(b), which grants that same status when adequate protection fails, remains unclear. Second, no definite agreement has been reached on what creditor action is sufficient to entitle a creditor to section 507(b) expenses. The next section argues that the submission of an adequate protection request is enough to entitle the creditor to superpriority status for any amount not adequately protected.

#### B. *Administrative Expenses Under Section 507*

The method of providing adequate protection through allowance of administrative expenses and the responsibility of the creditor in claiming such expenses are not clear. Section 361 excludes administrative expenses as an acceptable method of adequate protection.<sup>51</sup> Thus, some courts have held that administrative expense priority is available only under section 507(b) and only to those creditors whose previously provided adequate protection has proved deficient.<sup>52</sup> This rule can produce harsh results which do not appear necessary to advance the policy issues adequate protection and limitation of administrative expense attempt to address.

This section first presents a unique method of claiming adequate protection found valid in *In re Prime, Inc.*<sup>53</sup> This method circumvents many of the adequate protection limitations, and conflicts with legislative intent and policy goals. Second, this section focuses on cases illustrating the problems which occur when courts require a grant of adequate protection prior to an administrative expense allowance. These cases suggest that an amendment to section 507(b) is necessary to balance more properly the need to encourage diligence by creditors with the desire not to penalize those creditors whose request for adequate protection is delayed or denied.

---

50. See *infra* notes 63, 75 and accompanying text.

51. *Edwards Statement*, *supra* note 29 and accompanying text.

52. *In re James B. Downing & Co.*, 94 Bankr. 515 (Bankr. N.D. Ill. 1988); *In re Kain*, 86 Bankr. 506 (Bankr. W.D. Mich. 1988); *In re Smith*, 75 Bankr. 365 (W.D. Va. 1987).

53. 37 Bankr. 897 (Bankr. M.D. Mo. 1984).

### 1. *Claims for Administrative Expenses Under Section 503*

Traditional requests for allowance of claims for administrative expenses by prepetition creditors are made under section 507(b). The bankruptcy court then grants an administrative expense allowance if the adequate protection originally provided has failed. Some creditors have argued that they are entitled to allowance of administrative expenses directly under section 507(a)(1)<sup>54</sup> because the use of collateral constitutes one of the "necessary costs and expenses of preserving the estate."<sup>55</sup>

At least one court has responded favorably to these arguments, awarding creditors priority for administrative expense claims in order to compensate for a decline in the value of their collateral even though they had failed to ask previously for adequate protection. The court in *In re Prime, Inc.*<sup>56</sup> granted an administrative expense allowance to a creditor based on the belief that the use of collateral resulted in a benefit to the estate.

During reorganization, the debtor in *Prime* used tractors and trucks that were assigned as collateral for loans from two creditors. Neither creditor made any request for adequate protection following the debtor's bankruptcy petition. After twenty-one months, the creditors sought to collect administrative expenses for the depreciation resulting from wear and tear on the collateral. The creditors requested priority for administrative expense only under section 503(b)(1)(A) and not section 507(b) superpriority expense.<sup>57</sup> The creditors argued they were entitled to an administrative expense allowance since use of the equipment amounted to one of the "actual, necessary costs and expenses of preserving the estate."<sup>58</sup> The court held that the creditors were entitled to some administrative allowance due to their contribution of the "value of their collateral over the period of use."<sup>59</sup> The court recognized that section 507(b) expenses were not allowable since no request for adequate protection was made, but its finding of postpetition contribution circumvented that section's requirements.<sup>60</sup>

The Code does not explicitly prohibit the holding in *Prime* — granting section 503 administrative expense priority for collateral depreciation is not specifically excluded. In fact, whenever courts award a 507(b) administrative expense superpriority for collateral deprecia-

---

54. 11 U.S.C. § 507(a)(1) (1988).

55. 11 U.S.C. § 503(b)(1)(A) (1988).

56. 37 Bankr. 897 (Bankr. W.D. Mo. 1984).

57. The creditors in *Prime* were not entitled to a superpriority expense because such a remedy is available only where adequate protection fails; here, no adequate protection had been granted. 37 Bankr. at 899.

58. 37 Bankr. at 898 (quoting 11 U.S.C. § 503(b)(1)(A) (1988)).

59. 37 Bankr. at 898-99.

60. 37 Bankr. at 899.

tion, they must characterize that depreciation as an allowable 503(b) expense.<sup>61</sup> Section 507(b) allows administrative expense superpriority when two conditions are met: (1) adequate protection has been provided, and (2) notwithstanding such provision, a claim exists for administrative expense as defined in section 503(b). Congress recognized that section 507(b) applies specifically when adequate protection fails.<sup>62</sup>

The tension between the Code sections becomes obvious in *Prime* where the creditors were not formally requesting adequate protection but rather an expense recovery for the use of equipment. *Prime* suggests that since a postpetition creditor furnishing assets would be paid, prepetition creditors who make essentially the same contribution by allowing their collateral to be used during reorganization should also be compensated. A bankruptcy court in Minnesota rejected this argument in *In re Briggs Transportation Co.*<sup>63</sup> The court noted that "[e]ven if [the debtor] had benefited, it does not necessarily follow that [the debtor] has incurred an expense."<sup>64</sup> The court in *In re Advisory Information & Management Systems, Inc.* followed this reasoning, rejected the *Prime* holding, and stated that a secured creditor "is not contributing anything to the estate by sitting back and 'allowing' a debtor-in-possession to use collateral which it already owns and has a statutory right to use."<sup>65</sup>

Despite the creditors' arguments above, the *Prime* holding conflicts with the intent and policies of the Code. Even if the debtor does receive a benefit from using the collateral, as required by section 503, the Code should be read to encourage early adequate protection requests and preclude administrative expense allowances or priority for prepetition creditors except under section 507(b). The drafters clearly intended prepetition creditors to receive compensation only through the adequate protection methods in section 361, which excludes a section 507(a), and therefore a section 503, administrative expense.<sup>66</sup> The methods mentioned in section 361 were meant specifically to address various types of secured creditors. The first method, cash payments, was designed to "compensate for the expected decrease in value of the opposing entity's interest . . . for example . . . deprecia[tion] at a rela-

---

61. Although depreciation is recognized as an expense for income statement purposes, it in fact is viewed as a "cost recovery" or prepaid expense. I.R.C. § 168 (1988). This view of depreciation is difficult to reconcile with the traditional reorganization-accorded expenses and costs under § 503, such as manufacturing costs, salaries, and attorneys' fees.

62. *Edwards Statement*, *supra* note 29, at 32398.

63. *In re Briggs Transp. Co.*, 47 Bankr. 6 (Bankr. D. Minn. 1984).

64. 47 Bankr. at 7.

65. 50 Bankr. 627, 630 (Bankr. M.D. Tenn. 1985). It should be noted that a superpriority allowance is in fact based on the recognition that a creditor has an allowable § 503 claim which has been inadequately protected, not on whether an expense occurred.

66. 11 U.S.C. § 361 (1988); see *supra* note 13 for relevant text.

tively fixed rate.”<sup>67</sup> The second method provides similar compensation through an interest in additional property. Because of the uncertainty that the estate would be sufficient to pay the expenses in full, Congress deleted the provision of adequate protection through administrative expense priority.<sup>68</sup> Only through the exception provided in section 507(b) is such an expense priority granted. Congress must have viewed the methods of section 361 as adequate.

In addition to the lack of congressional intent, several courts have recognized policy-based problems present in the reasoning in *Prime*. The principal argument present in *In re Advisory & Management Systems, Inc.*<sup>69</sup> for denying an administrative expense recovery under section 503(a)(1) is based on the policies underlying section 503 and its predecessor, section 64a(1) of the Bankruptcy Act.<sup>70</sup> These policies include facilitating rehabilitation<sup>71</sup> and encouraging third parties to supply goods and services. Providing first priority to postpetition creditors induces extension of credit, enabling the debtor to continue operations. Prepetition creditors benefit from this priority status in that the debtor’s continued operation and chance for rehabilitation improve the likelihood of full payment. The court in *In re Mammoth Mart, Inc.*<sup>72</sup> summed up these policies in holding that, because the trustee or debtor in possession acts as a distinct entity operation for the benefit of prepetition creditors, “fairness requires that any claims incident to the debtor-in-possession’s operation . . . be paid before those of creditors for whose benefit the continued operation of the business was allowed.”<sup>73</sup> Some courts, recognizing the importance of these policies, have held that giving preference to claims clearly not intended to be covered by section 503(a) must be avoided and the statute read narrowly.<sup>74</sup> By reading the statute narrowly, prepetition creditors would become ineligible for administrative expense priority.

A second policy-based argument, made by the court in *In re Briggs Transportation*, concerns the effect an allowance of administrative expenses under section 507(a)(1) would have on bankruptcy proceedings.<sup>75</sup> The court expressed concern that creditors, after taking no

---

67. SENATE REPORT, *supra* note 18, at 54, reprinted at 5840.

68. SENATE REPORT, *supra* note 18, at 54, reprinted at 5840.

69. 50 Bankr. 627 (Bankr. M.D. Tenn. 1985).

70. Bankruptcy Act § 64a(1), 52 Stat. 874 (1938) (repealed 1978).

71. See *supra* note 2 and accompanying text.

72. 536 F.2d 950 (1st Cir. 1976).

73. 536 F.2d at 954.

74. *In re Chicago, M., St. P. & Pac. R.R.*, 658 F.2d 1149, 1163 (7th Cir. 1981), cert. denied, 455 U.S. 1000 (1982); *In re James B. Downing & Co.*, 94 Bankr. 515, 521 (Bankr. N.D. Ill. 1988); *In re Greater Kansas City Transp., Inc.*, 71 Bankr. 865, 872-73 (Bankr. D. Kan. 1987); *In re White Motor Corp.*, 64 Bankr. 586, 593 (N.D. Ohio 1986).

75. The court in *In re Briggs Transportation* stated:

A creditor . . . could . . . do nothing regarding seeking relief from the automatic stay or requesting adequate protection for a long period of time including up until a plan was pro-

action for an extended period, could request allowance for administrative expenses on the eve of confirmation of the reorganization. This action could effectively veto any plan since administrative expenses must ordinarily be paid in full on the date of confirmation. Requiring a creditor to request adequate protection prior to being eligible for administrative expense treatment reduces this possibility. When adequate protection is requested immediately before confirmation, the creditor should at most be eligible for protection from the date of request to the court.<sup>76</sup> The amount of entitlement should therefore be minimal and not seriously affect the plan confirmation process.

As is apparent, Congress designed adequate protection to make certain that secured "creditors [are not] deprived of the benefit of their bargain."<sup>77</sup> Since Congress has provided adequate protection to prepetition creditors, administrative expense allowance should not be granted except under section 507(b). As noted in *Advisory Information*, the possibility of dealing with a bankrupt debtor is "one of the many considerations a lender must evaluate at the time of the original loan."<sup>78</sup> Since the creditor is not electing to do postpetition business with the debtor, she should not be allowed administrative expense priority that Congress designed to encourage such election.

## 2. *Grants of Administrative Expenses Under Section 507(b)*

If creditors are not eligible for administrative expense priority through sections 507(a)(1) or 503(a), they can look only to section 507(b). Most courts have held, based on the statutory language, that administrative expense allowances are available to prepetition creditors only when the trustee has provided adequate protection that later proves deficient.<sup>79</sup> A strict reading of this language can produce inequitable results when a request for adequate protection is made but the actual provision of adequate protection is delayed or ignored.<sup>80</sup> Since the only prerequisite to the grant of adequate protection under sections 362 and 363 is the filing of an appropriate request, and under section 364 such protection is a prerequisite to the grant of a superior or equal lien, the availability of administrative expense priority should

---

posed. Then long into the case, the creditors could step forward, make requests for payment of administrative expense which would at that point be a sum which the debtor would be unable to pay. Since § 1129(a)(9)(A) requires that all of these priority administrative expenses be paid in full on the effective date of confirmation, such creditors could effectively veto any plan.

47 Bankr. 6, 8 (Bankr. D. Minn. 1984).

76. See *supra* notes 48-49 and accompanying text.

77. See *supra* note 8.

78. 50 Bankr. 627, 629 (Bankr. M.D. Tenn. 1985).

79. See *supra* note 46. The court in *In re Callister* limited the claims that can be made when adequate protection is deficient. Allowances were granted only for value unexpectedly or unforeseeably lost over the course of the case. 15 Bankr. 521, 528 (Bankr. D. Utah 1981).

80. See *infra* notes 82-84 and accompanying text.



be dependent on the creditors' taking the proper actions. Priority should not depend on the actual granting of adequate protection. Many of the policy arguments for requiring a grant of adequate protection also support an amendment to section 507(b) to require only that the creditor have first requested adequate protection.

This section analyzes the application of section 507(b) in its current form and its production of inequitable results. First, it reviews several cases revealing the problems which the statutory language can generate. Second, the section proposes an amendment to section 507(b) that should reduce its potential unfairness.

Courts considering administrative expense claims under section 507(b) traditionally require the creditor to meet two criteria: (1) that adequate protection was provided by the trustee, and (2) that it proved deficient. These courts refuse to give superpriority to creditors who fail to meet both requirements.<sup>81</sup> A refusal, based solely on the fact adequate protection was not provided, produces particularly unfair results for creditors whose collateral has been subject to senior or equal liens under section 364. These creditors have no duty to request adequate protection and should not be penalized for a debtor's failure to provide such protection. Inequitable outcomes also result in cases where adequate protection is not provided despite affirmative acts taken by the creditor for the purpose of obtaining protection.

In several cases the application of the above criteria has produced harsh results for creditors who were diligent in requesting adequate protection but who did not receive protection due to delay or court action. The court in *In re Smith* based its denial of administrative expense partially on the fact that adequate protection had not been provided.<sup>82</sup> The creditors had requested adequate protection seven months after the petition was filed because the debtor's financial condition continued to deteriorate. No order was filed until eighteen months later, after a second adequate protection request. In the eventual order the bankruptcy court judge found that, while the creditors were entitled to adequate protection, they would be afforded priority only under section 507(a)(1) since no assets were available to provide protection. The district court held section 507(a)(1) administrative expenses were not allowable at least in part because adequate protection had not been granted.<sup>83</sup> A similar outcome occurred in *In re James B. Downing & Co.* where the bankruptcy court denied priority because the creditors' earlier motion for adequate protection had been dis-

---

81. See *In re James B. Downing & Co.*, 94 Bankr. 515 (Bankr. N.D. Ill. 1988); *In re Smith*, 75 Bankr. 365 (W.D. Va. 1987).

82. 75 Bankr. 365, 369 (W.D. Va. 1987) (request for § 507(b) administrative expense priority denied because adequate protection not previously provided and because requested expenses could not be deemed administrative expenses).

83. 75 Bankr. at 369.

missed as moot.<sup>84</sup>

Both decisions illustrate a major problem arising from a strict statutory interpretation of section 507(b). In *Downing* and *Smith* the creditors had acted diligently in requesting adequate protection, but protection was denied due to judicial determination or delay and the creditor became ineligible for administrative expenses. A creditor should not be so penalized when she has fulfilled her duty to request protection. The section 507(b) requirement of previous adequate protection works to ensure that creditors do not wait until late in a reorganization case and then claim administrative expenses back to the date of the petition. But in a case where a creditor has requested adequate protection, especially where she actually had filed a motion for protection, the debtor has adequate notice that the creditor must be compensated for any loss in collateral prior to confirmation. Such compensation must be arranged prior to confirmation.

Requiring adequate protection actually to be provided also produces an unfair result when the claim for administrative expenses is the result of an additional lien granted under section 364. Here the creditor need not request adequate protection since the right to such protection is a prerequisite to the granting of a senior or equal lien. This provides a unique situation under section 507(b), since adequate protection is the responsibility of the debtor. This dilemma was confronted in *In re Center Wholesale, Inc.*<sup>85</sup> In *Center Wholesale* the bankruptcy judge had signed a collateral order which, in effect, gave a postpetition creditor a senior lien on collateral assigned to a prepetition creditor. On appeal, the circuit judge remanded and suggested the bankruptcy court grant the prepetition creditor a superpriority under 507(b). In a footnote the judge noted the usual application of section 507(b) to situations when adequate protection fails, but "although not literally within the provisions of section 507, [the creditor's] injury is clearly within its spirit."<sup>86</sup> This holding appears equitable because the creditor should not be penalized for the debtor's failure to provide adequate protection when the debtor had an affirmative duty to do so.

---

84. 94 Bankr. 515 (Bankr. N.D. Ill. 1988).

85. 759 F.2d 1440 (9th Cir. 1985).

86. The footnote reads in its entirety:

Section 507(b) addresses the situation where the debtor in possession initially provides protection that, after the fact, turns out to be inadequate. In [this] case, [the debtor] never provided protection in the first place. Therefore, although not literally within the provisions of section 507, [the creditor's] injury is clearly within its spirit and deserves to be remedied by granting its claim a superpriority. Cf. *In re Prime*, 35 Bankr. 697 (Bankr. W.D. Mo. 1984) (secured creditor is entitled to a superpriority under section 507(b) even though debtor had previously entered into a settlement with the creditor instead of proving to the court that debtor could adequately protect the creditor's interest).

759 F.2d at 1451 n.23. As discussed, the outcome of *Center Wholesale* is not justified under the reasoning of *Prime*. It is justified based on the debtor's duty to provide adequate protection.

All three of the above cases evidence the problems produced by strict application of the current wording of section 507(b). While the requirement that adequate protection be provided before a superpriority will be granted ensures creditor diligence and effective reorganization, these purposes can also be addressed by requiring only a request prior to a section 507(b) allowance. The current wording helps to prevent late requests for expenses from interfering seriously with confirmation of a pending plan. The previous provision of adequate protection guarantees that the debtor in possession or trustee is aware an administrative expense allowance may be necessary to protect the creditor fully. If a creditor requests adequate protection, however, and the request is subsequently denied, delayed, or ignored, the debtor still has been put on notice of the creditor's claims and concerns. It should therefore be the debtor's responsibility to respond to that claim, whether directly through adequate protection or through the eventual allowance of administrative expenses.

Two potential problems may result from a change in the language of section 507(b) to require a mere request on the part of the creditor. First, requests for adequate protection may increase as creditors try to guarantee some type of protection against a decline in the value of their collateral. This type of action could be reduced if the court later recognized only good faith adequate protection requests that were actively pursued. Creditors who file a request, with no intention of pursuing the claim, are taking the risk that the estate will be inadequate to permit recovery. Second, requiring a request may increase litigation immediately prior to reorganization as the debtor and creditor try to determine the value of the collateral. These valuation disputes would have been addressed if the adequate protection had not been delayed or ignored. The number of disputes could be reduced by requiring some type of valuation to accompany the request for adequate protection and by recognizing the values contained in motions to use or dispose of property and motions to obtain credit. The creditor is entitled to some type of protection; an increase in court costs should not infringe on this entitlement.

In order to reflect the debtor's responsibility properly, section 507(b) should be amended to require the creditor only to take the affirmative steps specified by sections 362, 363, and 364.<sup>87</sup> This would force the creditor to request adequate protection prior to the use, sale,

---

87. After amendment, section 507(b) might read:

If the court, under section 362 or 363, has received a request for adequate protection of the interest of a holder of a claim secured by a lien on the property of the debtor, or under section 364, has granted a lien on property on which an entity holds a superior lien, and if, notwithstanding such protection, such creditor has a claim allowable under subsection (a)(1) of this section arising from the stay of action against such property under section 362 of this title, from the use, sale, or lease of such property under section 363 of this title, or from the granting of a lien under section 364(d) of this title, then such creditor's claim under such subsection shall have priority over every other claim allowable under such subsection.

or lease of the collateral, or when seeking relief from the automatic stay. Whether adequate protection was ever provided should not be an issue, except in determining damages. When an additional lien on collateral has been granted, the creditor should be entitled to an administrative expense allowance regardless of whether adequate protection was ever requested. By amending the language of section 507(b), Congress not only would guarantee that the debtor receives the protections afforded by section 507(b), but would also avoid unfairly penalizing the creditor for court actions beyond her control.<sup>88</sup>

Before being entitled to any administrative expense allowance, a creditor must meet certain procedural requirements. Some dispute exists over what actions constitute the "provision" of adequate protection as required by the language in the current section 507(b). Under the suggested amendment, it would be necessary to determine what procedural steps establish the existence of an adequate protection request.

### III. PROCEDURAL MECHANISMS FOR OBTAINING ADEQUATE PROTECTION

In order for a creditor to be entitled to an administrative expense allowance under current Code provisions, it must be determined that adequate protection has been "provided" previously. It is unclear what procedural actions must be taken in order for the adequate protection agreement to be considered valid and enforceable. In order for adequate protection and administrative expense superpriorities to be administered efficiently, a concrete and uniform system for providing such relief must be established. If the amendment to section 507(b) suggested in Part II of this Note is adopted, it would be necessary to adopt a similar definition or system to determine when an adequate protection request has been made. Section III.A analyzes the current procedural mechanisms and the court decisions relating to the provision of adequate protection. Section III.B reviews current case law concerning adequate protection requests and its application if Code

---

88. A creditor may also have a cause of action based on the fifth amendment. If a delay on the part of the court results in a failure to give adequate protection, and administrative expense priority is then denied, a constitutional claim may be available based on the taking of property without due process. Congress recognized that a debtor, in proposing an adequate protection plan, was

not intended to be confined strictly to the constitutional protection required, however. The section, and the concept of adequate protection, is based as much on policy grounds as on constitutional grounds. Secured creditors should not be deprived of the benefit of their bargain. There may be situations in bankruptcy where giving a secured creditor an absolute right to his bargain may be impossible or seriously detrimental to the bankruptcy laws. Thus, this section recognizes the availability of alternate means of protecting a secured creditor's interest. Though the creditor might not receive his bargain in kind, the purpose of the section is to insure that the secured creditor receives in value essentially what he bargained for.

HOUSE REPORT, *supra* note 7, at 339, reprinted at 6295.

section 507(b) was amended to require only adequate protection requests. This Part proposes that an adequate protection request be recognized only when it is made to the court and notice is given to other creditors.

### A. Provisions of Adequate Protection and Rule 4001

Presently, courts disagree on whether adequate protection agreements must be court approved and notice given to other creditors, or, alternatively, whether consensual agreements and stipulations between a creditor and debtor are automatically enforceable.<sup>89</sup> The Code itself provides little assistance in determining whether court approval is necessary.<sup>90</sup> Bankruptcy Rule 4001, including recently proposed amendments, provides a procedural mechanism the debtor may follow when seeking court approval for an adequate protection agreement.<sup>91</sup> A problem remains, however, because the rule does not require a debtor to provide notice or to seek court approval for all agreements. Thus the question of the enforceability and validity of some consensual agreements remains. Section III.A.1 reviews both the current and proposed versions of rule 4001 and explains their provisions. Section III.A.2 considers several policy concerns regarding consensual agree-

---

89. Compare *In re Blehm Land & Cattle Co.*, 859 F.2d 137 (10th Cir. 1988) (failure to obtain court approval of an agreement held not fatal to a claim) and *In re Cheatham*, 91 Bankr. 382 (Bankr. E.D.N.C. 1988) (superpriority expense allowed when consensual adequate protection agreement filed) with *In re B & W Tractor Co.*, 38 Bankr. 613 (Bankr. E.D.N.C. 1984) (agreements not court approved subjected to close scrutiny).

90. The Code does not specifically mention the necessity of court approval for any of the adequate protection methods suggested in § 361. An argument that the Code does in fact require court approval of adequate protection agreements, however, is presented in a footnote in *In re Engle*. The footnote reads in full:

Under § 549 of the bankruptcy code, the Trustee may avoid post-petition transfers of property of the estate where such transfers are "not authorized under this title or by the court." 11 U.S.C.A. § 549(a)(2)(B) (Supp. 1987). An interesting question arises whether adequate protection payments made postpetition require court approval or are "authorized under this title" by §§ 361 and 362(d). The official comments to § 362 suggest that court involvement in adequate protection arrangements should be minimal. In fact, the comments suggest that court involvement should be limited to cases where the adequate protection negotiations fail and the creditor seeks relief from the stay under § 362. The comment states: "This section specifies means by which adequate protection may be provided but, to avoid placing the court in an administrative role, does not require the court to provide it. Instead, the trustee or debtor in possession or the creditor will provide or propose a protection method. If the party that is affected by the proposed action objects, the court will determine whether the protection provided is adequate." 11 U.S.C.A. § 361, comment 1 (1979). I need not decide whether court approval is required by statute in all cases, however, because the stipulation at issue here required court approval as a condition.

*In re Engle*, 93 Bankr. 58, 61 n.3 (E.D. Pa. 1987).

A second statutory argument, based on Bankruptcy Rule 9019, was rejected in *In re Bramham*. Rule 9019 requires notice, hearing, and court approval for a compromise or settlement of a controversy. The court in *In re Bramham* held that an adequate protection stipulation was more of a "vindication of a statutory right" than a settlement and that "something more than mere adequate protection of an allowed secured claim" was required before rule 9019 hearings were required. 38 Bankr. 459, 466 (Bankr. D. Nev. 1984).

91. Proposed Rules, *supra* note 24, at 105, reprinted at CCCIII.

ments. Finally, section III.A.3 analyzes the rule's effectiveness in addressing these concerns and suggests a revision to rule 4001(d) to ensure that unsecured creditors receive adequate notice, and an opportunity to object, prior to any adequate protection agreement.

### 1. *The Provisions of Proposed Bankruptcy Rule 4001*

The amendments proposed to Bankruptcy Rule 4001 are designed to expand the rule to include motions to prohibit or condition the sale, use, or lease of property.<sup>92</sup> The rule, as currently worded, addresses motions for relief from stay, motions for authorization to use cash collateral, motions to obtain additional credit, and agreements relating to any of these motions.<sup>93</sup> The current and proposed rules provide a procedural mechanism that gives creditors notice of various activities concerning the debtor estate and an opportunity to object when the activity affects their collateral position. The proposed rule establishes an effective notice and hearing system but does not require creditors and debtors to use the system for all agreements.

Subdivision (a)(1) of proposed rule 4001<sup>94</sup> requires debtors to give notice, to the creditors' committee<sup>95</sup> or all creditors included on file under rule 1007(d),<sup>96</sup> of all motions under Code section 362 for relief from an automatic stay, and all motions under Code section 363 to prohibit or condition the use, sale, or lease of property. Subdivisions (b) and (c) set out similar requirements for motions for authorization to use cash collateral and agreements to obtain additional credit. The proposed rule allows an exception from the notice or hearing requirements for court determination that the debtor must act immediately to

---

92. Proposed Rules, *supra* note 24, at 110, *reprinted* at CCCVIII.

93. 11 U.S.C. app. — Bankruptcy Rule 4001.

94. Section (a)(1) provides in full:

Motion. A motion for relief from an automatic stay provided by the Code or a motion to prohibit or condition the use, sale, or lease of property pursuant to § 363(e) shall be made in accordance with Rule 9014 and shall be served on any committee elected pursuant to § 705 or appointed pursuant to § 1102 of the Code or its authorized agent, or, if the case is a chapter 9 municipality case or a chapter 11 reorganization case and no committee of unsecured creditors has been appointed pursuant to § 1102, on the creditors included on the list filed pursuant to Rule 1007(d), and on such other entities as the court may direct.

Proposed Rules, *supra* note 24, at 105, *reprinted* at CCCIII.

95. Section 1102 requires a creditors' committee in Chapter 11. The committee consists of persons holding the seven largest unsecured claims against the debtor. 11 U.S.C. § 1102 (1988). The U.S. trustee may appoint other committees. Similarly, under § 705, a creditors' committee may be appointed in a Chapter 7 case. 11 U.S.C. § 705 (1988).

96. Bankruptcy Rule 1007(d) requires Chapter 9 and voluntary Chapter 11 debtors to file a list of the 20 largest unsecured creditors. In most cases this notice, or notice to the creditors' committee, is adequate to protect creditors. More extensive notice requirements may unduly burden the debtor. See Tabb, *Lender Preference Clauses and the Destruction of Appealability and Finality: Resolving a Chapter 11 Dilemma*, 50 OHIO ST. L.J. 109, 148-54 (1989) (arguing that sending initial notice of the case to all interested parties and sending notice of subsequent actions to a representative group is adequate to satisfy due process demands).

prevent irreparable injury.<sup>97</sup>

Subdivision (d) of the current rule addresses agreements establishing adequate protection and related activities including relief from an automatic stay, the use of cash collateral, and the obtaining of credit. As with subdivision (a), the proposed rule expands subdivision (d) to include agreements prohibiting or conditioning the use or disposition of property.<sup>98</sup> The rules require notice to the creditors' committee or all creditors on the rule 1007 list when parties seek court approval for any of the above agreements. Court approval is discretionary. If the notified creditors fail to file an objection, the court may then enter an order approving or disapproving the agreement without holding a hearing. Subdivision (d)(4) allows the notice and hearing procedures for agreements to be waived if the judge finds that motions previously made — for relief from stay, prohibition, or conditioning the use of property disposition, obtaining credit, or use of cash collateral — afforded creditors reasonable notice of the terms of an agreement subsequently made to settle the motion.<sup>99</sup>

It should be noted that the proposed rule addresses only motions that creditors have filed seeking action by the court or approval of an agreement. The rule would still allow debtors and creditors to enter into some adequate protection agreements without seeking a formal court order or approval.<sup>100</sup> In order to determine whether such private agreements should be allowed, it is necessary to look at policy concerns raised by private agreements and the effectiveness of the procedural mechanisms of rule 4001 in addressing these concerns. Rule

---

97. 11 U.S.C. app. — Bankruptcy Rules 4001(b)(2) and (c)(2).

98. Section (d)(1) provides in full:

Motion; Service. A motion for approval of an agreement (A) to provide adequate protection, (B) to prohibit or condition the use, sale, or lease of property, (C) to modify or terminate the stay provided for in § 362, (D) to use cash collateral, or (E) between the debtor and an entity that has a lien or interest in property of the estate pursuant to which the entity consents to the creation of a lien senior or equal to the entity's lien or interest in such property shall be served on any committee elected pursuant to § 705 or appointed pursuant to § 1102 of the Code or its authorized agent, or, if the case is a chapter 9 municipality case or a chapter 11 reorganization case and no committee of unsecured creditors has been appointed pursuant to § 1102, on the creditors included on the list filed pursuant to Rule 1007(d), and on such other entities as the court may direct. The motion shall be accompanied by a copy of the agreement.

Proposed Rules, *supra* note 24, at 108-09, reprinted at CCCVI.

99. Proposed Rules, *supra* note 24, at 110. Notice of various adequate protection agreements may be included in the information filed in conjunction with the original motions. For example, the motion for authority to use cash collateral should include "the nature of the protection to be provided those having an interest in the cash collateral." Notes of Advisory Committee on Rules — 1987 Amendment, Bankruptcy Rule 4001, reprinted in 11 U.S.C. app. at 257-58. A motion to obtain credit should also describe "the protection for any existing interest in the collateral which may be affected by the proposed agreement." *Id.* at 258.

100. Many of the agreements between debtors and creditors are subject to notice and hearing requirements of other sections of the Code. See 11 U.S.C. §§ 362(d), 363(b), 364(b) (1988). Other agreements, such as for a future payment of cash, could be entered into with no notice to the unsecured creditors who are affected by the agreement.

4001 is important in determining when adequate protection is provided for the purposes of awarding section 507(b) expenses.

## 2. Policy and Rule 4001

Several courts have allowed adequate protection through allowance of administrative expenses when the original adequate protection is the result of a private agreement or stipulation between the debtor and creditor, or a stipulation subsequently approved by the court.<sup>101</sup> Other courts have required more before awarding a superpriority status.<sup>102</sup> These courts focus on the potential prejudice to other creditors and the impact on the courts' caseloads. A well-defined system of notice and hearing can prevent such prejudice while not unduly burdening the judiciary. This section explores the policy concerns an effective notice system must address.

The most obvious problem presented by private consensual agreements or stipulations is the possibility that the debtor will enter into an agreement unfairly benefiting one creditor. A biased agreement is more likely in Chapter 11 cases where the debtor may attempt to favor one creditor in order to secure a future source of funds.<sup>103</sup> Additionally, in Chapter 11 cases, the seven largest unsecured creditors form a creditors' committee that serves as the primary negotiator for the reorganization plan and supervises the debtor.<sup>104</sup> In these cases, the possibility exists that the concerns of those creditors on the committee do not reflect the concerns of all unsecured creditors. These policy concerns must be balanced with the possibility that the responsibility to make a detailed review of all adequate protection agreements could result in an increased and potentially overwhelming workload for the courts.

One method of review for consensual adequate protection agreements was adopted by the Tenth Circuit in *In re Blehm Land & Cattle Co.*<sup>105</sup> There, a Chapter 11 case involved a memorandum of agree-

---

101. *In re Cheatham*, 91 Bankr. 382 (E.D.N.C. 1988) (consent agreement held valid but risk of inadequacy of protection placed on the creditor); *In re Becker*, 51 Bankr. 975 (Bankr. D. Minn. 1985) (*ex parte* stipulation assumed to be valid in determining superpriority eligibility); *In re Callister*, 15 Bankr. 521 (Bankr. D. Utah 1981) (*ex parte* stipulations subsequently court-approved held to be valid). In these cases, the creditors sought superpriorities when the private adequate protection agreements failed to protect the creditors' collateral. Except for cases like these, where creditors are seeking § 507(b) expenses, private consensual agreements generally are not brought to the attention of other creditors.

102. *In re Blehm Land & Cattle Co.*, 859 F.2d 137 (10th Cir. 1988) (private adequate protection agreement must meet certain criteria prior to a grant of administrative expense priority); *In re B & W Tractor*, 38 Bankr. 613 (Bankr. E.D.N.C. 1984) (criteria for the review of private adequate protection agreements).

103. Elsewhere in the Code, Congress evidenced its concern that a debtor might act to prefer certain creditors. See, e.g., 11 U.S.C. §§ 547, 548 (1988).

104. See 11 U.S.C. § 1102(a)(1), (b)(1) (1988); HOUSE REPORT, *supra* note 7, at 401, reprinted at 6357.

105. 859 F.2d 137 (10th Cir. 1988).



ment between the debtor and creditor providing for periodic payments to the creditor for continued use of the property by the debtor. The debtor subsequently defaulted on the payments.<sup>106</sup> The trustee argued that the creditor was precluded from asserting a section 507(b) claim for administrative expenses because the court had not approved the memorandum of agreement. The court declared that requiring court approval for all adequate protection agreements would deprive the bankruptcy courts of flexibility.<sup>107</sup> Instead, it adopted a rule that any agreement brought before the court for enforcement should be subjected to close scrutiny to determine if it met the criteria set forth in a previous bankruptcy court case, *In re B & W Tractor Co.*<sup>108</sup> These standards were (1) whether the agreement was inconsistent with the objectives of the Bankruptcy Code, (2) whether the conduct of the creditor had been inequitable, and (3) whether allowing the agreement would produce an inequitable result.<sup>109</sup> These criteria work to limit the ability of the debtor and creditor to enter into an agreement which is prejudicial to other creditors by forcing the court to look at the agreement both in light of the Code and its effect on other creditors.

This method of review, however, fails to provide adequate protection for creditors not party to the agreements because these agreements are reviewed only when challenged by the protected creditor who discovers that the protection provided is inadequate. Private unapproved agreements that do provide adequate protection are never brought to the court's attention and therefore would never be subject to the review established by the court. Other creditors would never know of the agreement or have sufficient information to bring the agreement before the court. This is troubling because these agreements have been carried out to the advantage of the contracting parties, and the impact on the other creditors might be of special concern.

The court in *In re Callister* articulated several advantages of allowing creditors and debtors to negotiate freely their own agreements and stipulations. Although the court was addressing a stipulation that had been subsequently approved by the court, the arguments presented are also applicable to all types of consensual agreements. The court argued that stipulations

show cooperation between creditors and the estate which should be required. They reduce costs otherwise incurred in litigation and permit a constructive allocation of resources. They lessen the judicial burden of administering the estate, an important principle of the Reform Act. . . .

---

106. *In re Blehm Land & Cattle Co.*, 71 Bankr. 818, 820-21 (D. Colo. 1987).

107. 859 F.2d at 140. The court in *Blehm* relied on the flexibility discussed by Congress when adopting the Code. Congress was concerned with the flexibility to adapt the provision of adequate protection "to varying circumstances and changing modes of financing." HOUSE REPORT, *supra* note 7, at 339, reprinted at 6295.

108. 38 Bankr. 613 (Bankr. E.D.N.C. 1984).

109. 38 Bankr. at 617.

[M]ost authorities have assumed that a court order under 11 U.S.C. Section 362(d)(1) is essential for relief under 507(b). These authorities may be incorrect since 507(b) speaks in terms of the trustee not the court providing adequate protection, and this is consistent with the legislative history to 361.<sup>110</sup>

While cooperation between the debtor and creditor should be encouraged, the objectives of reducing cost, lessening judicial burdens, and preventing prejudice are best accomplished when notice is required prior to the validation of any adequate protection agreement.<sup>111</sup> Prior notice ensures that all adequate protection agreements have a chance to be reviewed by other creditors. Once creditors have been notified, the court and debtor should be entitled to rely on the silence of the other creditors. These creditors were given an opportunity to object to the provisions and cannot subsequently complain about the prejudicial relationship of the agreements. This prevents the court from having to review the agreement subsequently and thereby reduces judicial costs. The next section of this Note, III.A.3, analyzes whether proposed rule 4001 establishes an adequate notice and hearing system.

### 3. *Effectiveness of Rule 4001*

In order for the procedural mechanisms established in rule 4001 to be considered effective they must create a system which provides for adequate review of agreements without unduly burdening the courts or the creditors. This section shows that the proposed rule does meet these requirements when the parties to the agreement make a motion for court approval. The rule fails to protect all creditors, however, by omitting notice and hearing procedures for all adequate protection agreements. This section concludes that in order for the rule to protect effectively against unfair and prejudicial agreements, the rule should be amended to cover all adequate protection agreements between the debtor and any creditor.

The system of notice provided by proposed rule 4001 gives creditors the option of policing proposed agreements themselves in order to protect their interests. Under this system, a bankruptcy court is not obligated to undertake subsequent reviews of completed contracts since it will be entitled to rely on creditors' diligence in objecting within the fifteen days provided and treating failure to object as a waiver of rights. The individual creditors and the creditors' committee have an increased responsibility to review proposed agreements for

---

110. 15 Bankr. 521, 531-32 (Bankr. Utah 1981) (footnotes omitted).

111. Code § 1109(b) allows a party in interest to be heard on any issue. Collier notes that a rule requiring "a right to notice of all steps taken in the reorganization . . . would result in much unwarranted difficulty and expense." 5 COLLIER ON BANKRUPTCY ¶ 1109.02[3] (15th ed. 1979) (quoted in *In re Phillips*, 29 Bankr. 391, 393 (S.D.N.Y. 1983)). Here, only notice of adequate protection agreements is being advocated, not notice of all actions by the debtor.

adequate protection, conditioned sale, use, or lease of land, and motions to obtain credit to ensure that the debtor deals fairly with all parties.

The justification for the system of notice proposed by rule 4001 rests in part on the assumption that notice to the creditors' committee serves as adequate notice to all creditors. Professor Charles Tabb, in his article on lender preference clauses, argues that the creditors' committee is an effective representative body, and notice to the committee, after initial notice of the petition to all creditors, satisfies due process requirements.<sup>112</sup> The notice and hearing procedures for adequate protection agreements serve primarily to afford unsecured creditors a chance to reject agreements which unfairly affect their position. Notice to the committee will address this concern and has been found adequate by at least one bankruptcy court.<sup>113</sup> The other creditors must remain diligent in monitoring the creditors' committee's actions and require the committee to take an active role in the reorganization process.<sup>114</sup> This review, with the committee's opportunity to object through a formal hearing procedure, reduces the likelihood of unfair agreements.

The proposed rule also will reduce court costs and strains on court dockets since agreements can be negotiated and presented to the court and to other creditors in final form. Costs also will be reduced since courts may assume the validity of agreements unless objections are made within the required time. Finally, the court's workload will be lessened since hearings are held only when creditors object to an adequate protection provision.<sup>115</sup> This prevents the subsequent review of agreements as advocated by the court in *In re B & W Tractor Co.*<sup>116</sup> Subdivision (d)(4) in rule 4001 also lessens costs since additional notice of an adequate protection agreement is not required when original motions concerning debtor action provide adequate information to creditors.

A final argument for requiring notice and hearing prior to an adequate protection agreement is based on the fifth amendment constitutional protection of property, on which the concept of adequate

---

112. Tabb, *supra* note 96, at 148-54. See *supra* note 90 and accompanying text.

113. *In re Photo Promotion Assoc.*, 53 Bankr. 759, 762-63 (Bankr. S.D.N.Y. 1985).

114. Section 1102 contains several provisions designed to ensure that all creditors receive adequate representation in negotiations with the debtor. Section 1102(a) authorizes the court "to appoint such additional committees as are necessary to assure adequate representation of creditors . . ." HOUSE REPORT, *supra* note 7, at 401, *reprinted* at 6357. Section 1102(c) "authorizes the court, on request of a party in interest, to change the size or the membership of a creditors' . . . committee if the membership of the committee is not representative of the different kinds of claims or interests to be represented." HOUSE REPORT, *supra* note 7, at 401, *reprinted* at 6357.

115. Rule 4001(d)(3) provides that "[i]f no objection is filed, the court may enter an order approving or disapproving the agreement without conducting a hearing." 11 U.S.C. app. — Bankruptcy Rule 4001(d)(3).

116. 38 Bankr. 613 (Bankr. E.D.N.C. 1984); see *supra* notes 108-09 and accompanying text.

protection is based.<sup>117</sup> Before any person's property is taken, due process must be provided. This right was recognized by the court in *In re Blumer*.<sup>118</sup> The court refused to uphold a deed of trust the debtor entered into under section 364. The court's refusal was based on the right of the other creditors to notice under section 364(e) and under the Constitution. The court noted that "unsecured creditors are entitled to procedural due process" when their rights are affected.<sup>119</sup> This constitutional argument provides a final justification for a right already firmly grounded in policy.

Rule 4001 provides for notice of most types of adequate protection agreements with which other creditors would be concerned. Any notice of motions involving the use of cash collateral or the obtaining of credit is sent to the representative creditor group. If the proposed amendment is accepted, notice of a motion to use, lease, or sell property would also be sent. Notice of these motions, as well as the notice required under Code sections 362(a), 363(b), and 364(b), ensures that unsecured creditors are informed of almost all adequate protection agreements affecting them. Some agreements, however, such as an agreement for a future payment of cash, may not fall under the notice requirements mentioned above. Thus, rule 4001 fails because it does not result in a uniform system of notice and hearing under which unsecured creditors are notified of all actions affecting the debtor's overall ability to pay unsecured creditors.

A uniform system of notice and hearing can be developed by re-writing rule 4001 to require standard notice and hearing procedures for all adequate protection agreements. This would establish uniformity in the system, and creditors would know to provide notice for all agreements and could make certain assumptions about assets for which no notice had been given. This requirement would appear appropriate in light of Congress' desire to reduce judicial administration,<sup>120</sup> yet would still ensure fair agreements. Uniformity would also be established firmly in the determination of when the provision of adequate protection actually occurs for purposes of a section 507(b) allowance.<sup>121</sup> If the amendment to section 507(b), as suggested in Part II, is adopted, a uniform definition of an adequate protection "re-

---

117. U.S. CONST. amend. V; see *supra* note 8.

118. 66 Bankr. 109 (Bankr. 9th Cir. 1986), *aff'd.*, 826 F.2d 1069 (9th Cir. 1987).

119. 66 Bankr. at 114; see *In re Center Wholesale, Inc.*, 759 F.2d 1440, 1448 (9th Cir. 1985).

120. See, e.g., HOUSE REPORT, *supra* note 7, at 339, *reprinted* at 6296 (Section 361 frequently should result in "negotiation between the parties. Only if they cannot agree will the court become involved.").

121. By requiring that notice of an adequate protection agreement be sent to a representative group of other creditors, there can be no dispute about when adequate protection was provided to a creditor. This helps to document when adequate protection is provided for purposes of § 507(b) administrative expense requests.

quest" would also need to be adopted. The next section of this Note, III.B, discusses the formulation of this definition.

### B. *Requesting Adequate Protection*

If section 507(b) of the Code were amended, as suggested in Part II, to require only that the creditor take the affirmative actions required under sections 362 and 363, entitling her to adequate protection,<sup>122</sup> it must be determined what actions by the creditor constitute a "request." Neither the Bankruptcy Code nor the Rules contain detailed procedures outlining a request for adequate protection. Most of the court decisions discussing adequate protection requests do so in connection with adequate protection valuation and depreciation. The cases suggest that only those requests made directly to the court should be considered. This rule avoids prejudicing either the debtor or the creditor and minimizes court time in determining when a request was made. Several relevant concerns are best articulated in decisions seeking to determine adequate protection valuation.

Cases concerning adequate protection valuation try to select a date from which collateral value will be protected. Creditors prefer early dates: for example, the petition date or the date when the request was made directly to the debtor.<sup>123</sup> Debtors, on the other hand, should seek to have collateral valuation established later in the process, such as on the adequate protection hearing date, to decrease awarded damages. The court in *In re Haiflich*<sup>124</sup> rejected both arguments and selected the date protection was first sought from the court.<sup>125</sup> The date the court selected was the day the creditor filed for relief from the stay and, alternatively, adequate protection. The court noted specifically that by choosing the date the creditor first requests protection from the court, "the Court avoids any unfairness which could result from delay by the parties or the Court's calendar."<sup>126</sup> The proposed amendment to section 507(b) seeks to avoid this same unfairness.

The choice of the date of the petition as the valuation date was rejected by the court in *In re Hinckley*.<sup>127</sup> The court feared an "in-

---

122. Since under § 364 adequate protection is a prerequisite to the grant of additional liens, a creditor whose security position is affected by additional liens should not be required to take any affirmative action in order to be entitled to adequate protection and, hence, administrative expense allowance. See *supra* notes 45-47 and accompanying text.

123. E.g., *In re Ritz-Carlton of D.C., Inc.*, 98 Bankr. 170 (S.D.N.Y. 1989); *In re Wilson*, 70 Bankr. 46 (Bankr. N.D. Ind. 1987); *In re Haiflich*, 63 Bankr. 314 (Bankr. N.D. Ind. 1986); *In re Hinckley*, 40 Bankr. 679 (Bankr. D. Utah 1984).

124. 63 Bankr. 314 (Bankr. N.D. Ind. 1986).

125. In making this decision the court noted the position taken by Collier: "In the case of an adequate protection valuation, the determinative date should be when the protection was first sought." 63 Bankr. at 316 (quoting 3 COLLIER ON BANKRUPTCY ¶ 506.04[2] (15th ed. 1985)).

126. 63 Bankr. at 316.

127. 40 Bankr. 679 (Bankr. D. Utah 1984).

crease [in] the number of such filings, which would, in turn, multiply litigation."<sup>128</sup> The court in *Hinckley* instead based adequate protection on the collateral value as of the date of the meeting of the creditors.<sup>129</sup> In this case, the creditors met several weeks before the creditor actually moved for adequate protection. The court held the selection of this date to be appropriate since it was the first time the creditor informed the debtor they would seek adequate protection.

Basing the valuation of collateral, or the existence of an adequate protection request, on the creditor's first informal request for adequate protection, however, may increase litigation costs. The court will be forced to decide whether the creditor asserted the right to adequate protection at a date earlier than the formal request. In contrast, a formal request serves as a concrete example of a creditor's assertion.

As noted in *In re Wilson*,<sup>130</sup> the valuation method chosen in *In re Haiflich* has two benefits over other dates that might be selected. Although the court in *Wilson* was attempting to determine the starting point for depreciation compensation, these benefits support defining "request" as a formal action by the creditor. The *Wilson* court decided that selecting the date protection is first sought was beneficial because "the rule does not reward the creditor for inaction."<sup>131</sup> A motion for adequate protection clearly shows the creditor asserting her right to protection of property. Considering such a motion as a "request" for purposes of section 507(b) may increase litigation, although, in theory, a creditor would normally file such a motion only when she believes her collateral is seriously decreasing in value. This increase in filings could be reduced if only good faith requests were recognized. This rule also rewards those creditors who carefully monitor their collateral and the debtor's actions to determine when adequate protection is indicated.

The second advantage enunciated by the *Wilson* court is that a motion "puts the debtor on notice at the time the creditor's motion is filed that at a future point in time the collateral will have to be relinquished," or adequate protection provided.<sup>132</sup> This same reasoning justifies the suggested amendment to section 507(b). Since the debtor has been put on notice by the creditor's request, that request should be the sole requirement to qualify for an administrative expense allowance. A formal request to the court for protection would guarantee

---

128. 40 Bankr. at 681.

129. The meeting of the creditors is discussed in § 341 which requires the U.S. Trustee to convene and preside over a meeting of the creditors within a reasonable time after the order for relief. 11 U.S.C. § 341 (1988).

130. 70 Bankr. 46 (Bankr. N.D. Ind. 1987).

131. 70 Bankr. at 48.

132. 70 Bankr. at 48.

that the debtor was notified. This definition would also lessen the likelihood of litigating the issue of when an informal request occurred.

The two benefits asserted by the *Wilson* court outweigh any disadvantages, such as the potential increase in litigation, from using the date of a motion for adequate protection to determine when an adequate protection "request" has occurred. Considering only a formal motion for adequate protection as a "request" under the proposed section 507(b) amendment establishes a uniform definition of "request." This definition would provide certainty to both creditors and debtors in determining when a section 507(b) administrative expense allowance is available.

### CONCLUSION

Adequate protection was designed to ensure the protection of a creditor's bargain and property. This protection, however, cannot be provided in a way that unfairly benefits that creditor at the expense of other creditors of a debtor. In order to prevent prejudicial treatment of one creditor, procedural mechanisms for awarding adequate protection, whether through the methods suggested in section 361 or through an administrative expense allowance, are necessary. The present provisions of the Bankruptcy Code and Rules fail to establish a system which provides effective adequate protection for a creditor and safeguards that creditor from unfair adequate protection agreements between the debtor and other creditors.

The current wording of Code section 507(b) results in the imposition of an unfair penalty when a request for adequate protection is denied, delayed, or ignored. The current section allows superpriority status to be given only to those creditors who previously have been provided with adequate protection. In order to protect truly a creditor's bargain, and to guarantee the creditor receives the "benefit of his bargain," the grant of administrative expenses should be predicated only on the request of adequate protection. Such a rule would benefit diligent creditors while still affording the debtor the protections provided by section 507(b) since the request requirement provides the debtor with notice.

The currently proposed rule 4001 can also result in a creditor being unfairly penalized even if she has monitored a debtor's actions diligently. The rule does not require notice of all agreements between creditors and debtors. The provisions of private agreements are of special concern to unsecured creditors since they often involve the assets from which such creditors can hope to recover in the case of liquidation. While a system of detailed court review of all agreements is undesirable because of the burden this would place on the courts, a system of notice to other creditors of all agreements is an effective policing mechanism. The creditors would then have a chance to re-

view all adequate protection agreements and object to those which they view as unfair or prejudicial. Such a system would seek to ensure that no creditor receives more, at the expense of others, than the benefit of her bargain.

— *Julia A. Goatley*